

Part III - Sources for Identification of Tax Shelters

Overview

Introduction This section deals with sources of information that can help identify tax shelters, and which should be considered in the pre-audit analysis. These sources include:

- Information available through OTSA
 - Technical Advisor information
 - Return information
 - Other information
-

Information Available Through OTSA OTSA receives information from taxpayers, promoters, and field agents that is useful in determining whether tax shelter items are claimed on a return. Information is derived from:

- Disclosure statements
 - Registration statements
 - Tax shelter surveys
 - Tax shelter hotline
 - Informants
 - Revenue agent audits
-

Additional Tools A check sheet and IDRs were developed that aid in the identification of tax shelters.

- Corporate Tax Shelter Check Sheet
 - IDRs
-

III.A. 1. Disclosure Statements

Introduction Temporary Treasury Reg. §1.6011-4T, provides guidelines and requirements on disclosure statements as discussed below.

Who Must File Every corporate taxpayer that is required to file a return for a taxable year with respect to a tax imposed under IRC §§ 11, 594, 801, or 831 and that has participated directly or indirectly in a “reportable transaction,” must attach to its return a disclosure statement. A taxpayer will have indirectly participated in a transaction if its federal income tax liability is affected by the transaction, even if it is not a direct party to the transaction (e.g., it participates through a partnership or through a controlled entity). A separate disclosure statement is required for each “reportable transaction.” A reportable transaction is either a listed transaction (or a substantially similar transaction), **or** a transaction which meets two out of five prescribed characteristics, **and** that meets the projected tax effect test. For details, definitions, characteristics, the projected tax effect test, and exceptions, see [Temp. Treas. Reg. §1.6011-4T](#).

NOTE: Effective June 14, 2002, this regulation was modified to extend the same reporting requirements to individuals, trusts, partnerships, and S Corporations.

Time and Place When participants in a “reportable transaction” file their tax returns, two copies of the disclosure statement are filed.

One copy is filed with the tax return **each year** that participation in the transaction affects the taxpayer’s tax liability. The other copy is filed with the Office of Tax Shelter Analysis, 1111 Constitution Ave., NW, The Mint Building, Washington, DC 20224 at the same time the disclosure statement is **first** attached to the taxpayer's federal income tax return.

Continued on next page

III.A. 1. Disclosure Statements, Continued

Effective Date Temp. Treas. Reg. §1.6011-4T applies to federal corporate income tax returns filed after February 28, 2000. However, paragraphs (a) and (e) apply to federal corporate income tax returns filed after August 11, 2000, and to documents and other records that the taxpayer acquires, prepares, or has in its possession on or after August 11, 2000. Taxpayers may rely on the rules in paragraphs (a) and (e) for federal corporate income tax returns filed after February 28, 2000, and for documents and other records that the taxpayer acquires, prepares, or has in its possession on or after February 28, 2000. Otherwise, the rules that apply with respect to federal corporate income tax returns filed after February 28, 2000, and records that the taxpayer acquires, prepares, or has in its possession prior to August 11, 2000, are contained in Treas. Reg. § 1.6011-4T in effect prior to August 11, 2000 (see 26 CFR part 1 revised as of April 1, 2000). [NOTE: These Temporary Regulations were revised in August of 2001. For details, see [2001 TNT 156-70 - IRS Temporary Regulations.](#)]

Continued on next page

III.A. 1. Disclosure Statements, Continued

Information to be Included in Disclosure Statements

The disclosure statement for each reportable transaction must include the information below and should be presented in a format preferably no longer than one page:

- (i) The name or a short designation of the transaction (to distinguish it from other reportable transactions);
- (ii) A statement indicating whether the transaction has been registered as a tax shelter, and if the transaction has been registered, an indication of whether Form 8271, "Investor Reporting of Tax Shelter Registration Number," has been filed with the taxpayer's return (this form provides the registration number);
- (iii) A brief description of the transaction;
- (iv) A brief description of the expected tax benefits of the transaction (e.g., loss deductions, interest deductions, rental deductions, foreign tax credits, etc.);
- (v) An identification of each taxable year (including prior taxable years) for which the transaction is expected to have the effect of reducing the taxpayer's federal income tax liability, and an estimate (which may be rounded to the nearest \$ 1 million) of the amount by which the transaction is expected to reduce the taxpayer's federal income tax liability for each such taxable year; and
- (vi) The names and addresses of any parties who promoted, solicited, or recommended the taxpayer's participation in the transaction and who had a financial interest, including the receipt of fees, in the taxpayer's decision to participate.

Continued on next page

III.A. 1. Disclosure Statements, Continued

Example

DISCLOSURE STATEMENT FOR REPORTABLE TRANSACTION
Corporation X (EIN)

(address)

1. *Identification of transaction:* LILo—Country W.

2. *Registration status under IRC § 6111:* Not registered.

3. *Description of transaction:* We leased a building from a municipality in W. We made an advance payment of rent of \$89 million. The lease term is 34 years. The foreign municipality subleased the asset back from us for a term of 20 years. The foreign municipality has the option, at the end of the sublease term, to buy out our interest for \$50 million. Our advance lease payment has been financed with a bank loan of \$60 million. The foreign municipality placed \$75 million of the advance rental payment in special accounts to satisfy the sublease and buyout obligations.

4. *Principal tax benefits:* Deductions for rental and interest payments in excess of income from leaseback rental payments.

5. *Estimates of expected reduction of federal income tax Liability for affected taxable years:* 1999-2002, \$5 million per year; 2003-2013, \$4 million per year; and 2014-2017, \$3 million per year.

6. *Promoters:*

Financial Institution Y

(address)

(telephone number)

Professional Service Firm Z

(address)

(telephone number)

Continued on next page

III.A. 1. Disclosure Statements, Continued

Relevance to Audit

When disclosure statements are received by OTSA, the following action is taken:

First, OTSA determines if the transaction is a “listed transaction.” If the information provided does not fit a known listed transaction, a copy is forwarded to OTSA’s Senior Legal Counsel, Corporate Tax Shelters for review.

After proper identification, a copy of the disclosure statement is provided to the appropriate Industry Director, with a request that it be forwarded to the Team Manager in charge of the taxpayer’s current audit.

A copy of the disclosure statement is also provided to the Technical Advisor (and his or her manager) who has coordination and assistance responsibilities for the transaction.

If a transaction appears to be a new type of tax shelter, OTSA evaluates it through the numerous resources at its disposal and makes a determination as to its potential abusive nature before recommending action.

OTSA’s involvement ensures that emerging tax shelter issues are identified and appropriate action taken early. Such action includes timely discussion and coordination at all levels and may lead to appropriate notice to the public that certain transactions are considered abusive.

For those taxpayers that have invested in the same or similar transactions, the timely notification (via Announcements or Notices) provides these taxpayers with the opportunity to comply with the tax laws by not including the tax shelter’s benefits on their tax returns or by allowing them to file amended returns.

Application of a Penalty

The investor in a listed transaction tax shelter may avoid a substantial penalty assessment by not including the tax shelter’s benefits on their tax return or by filing an amended return.

Examination teams have been instructed to consider and apply the appropriate penalties on all tax shelters.

For details, see Sections IV.A. 5 (Accuracy Related and Fraud Penalties) and V. (Resolution Strategies).

III.A.2. Tax Shelter Registrations

Introduction IRC §§ 6111 and 6112 require tax shelter organizers or sellers to register all tax shelters with the Secretary and to maintain lists of investors and information about the transactions. OTSA reviews all registrations and works with audit teams to obtain lists of investors involved in the tax shelters. These shelters are usually marketed to large numbers of investors. An audit of these investors may be recommended, depending on the facts and circumstances of the transactions. For details, see Section [VI Promoter Audit](#).

Time An organizer or seller of a tax shelter must register the shelter no later than the day on which the first offering for sale of interests in a tax shelter occurs by filing [Form 8264](#) with the Ogden Compliances Service Center. Information required on the registration includes identification and description of the tax shelter and the tax benefits represented to investors.

Registration and Identification Number The tax shelter organizer who registers will receive a notice containing the registration number and a tax shelter identifying number. Any person who sells (or otherwise transfers) an interest in the tax shelter is required to furnish the assigned registration and identification number to each investor who purchases (or otherwise acquires) an interest in the shelter.

Form 8271 Any person claiming any deduction, credit, or other tax benefit by reason of a tax shelter shall include on the tax return where such deduction, credit, or other benefit is claimed the registration and identifying number assigned by the Secretary to such tax shelter. The investor reports these numbers by attaching Form 8271 to the tax return. If the interest was purchased or otherwise acquired by a pass-through entity, both the pass-through entity and its partners, shareholders, or beneficiaries must file Form 8271.

Continued on next page

III.A.2. Tax Shelter Registrations, Continued

Confidential Corporate Tax Shelters

Recently issued regulations also require the registration of confidential corporate tax shelters. The new regulations require more tax shelters to be registered and provides a guide to agents regarding characteristics of tax shelters. For definitions of a confidential corporate tax shelter, see [Temp. Treas. Reg. §301.6111-2T](#)).

Effective Date

Treas. Reg. § 301.6111-2T applies to confidential corporate tax shelters in which any interests are offered for sale after February 28, 2000. If an interest is sold after February 28, 2000, it is treated as offered for sale after February 28, 2000, unless the sale was pursuant to a written binding contract entered into on or before February 28, 2000. However, paragraphs (b)(1), (b)(3)(ii), (b)(4)(i), (b)(6) Example (i) and (ii), (c)(3) and (e)(2)(ii)(E) of this section apply to confidential corporate tax shelters in which any interests are offered for sale after August 11, 2000. The rules in paragraphs (b)(1), (b)(3)(ii), (b)(4)(i), (b)(6) Example (i) and (ii), (c)(3) and (e)(2)(ii)(E) of this section may be relied upon for confidential corporate tax shelters in which any interests are offered for sale after February 28, 2000. Otherwise, the rules that apply to confidential corporate tax shelters in which any interests are offered for sale after February 28, 2000, are contained in § 301.6111-2T in effect prior to August 11, 2000 (see 26 CFR part 301 revised as of April 1, 2000). [NOTE: These Temporary Regulations were revised in August of 2001. For details see [2001 TNT 156-70 - IRS Temporary Regulations.](#)]

List of Investors

Any person who organizes a potentially abusive tax shelter or sells an interest in such a shelter has to maintain a list identifying each person who invested in the shelter.

Any person who is required to maintain a list shall make the list available to the Secretary for inspection upon request, and shall retain any information required to be included on such list for seven years. [Temp. Treas. Reg. § 301.6112-1T](#).

III.A.3. Tax Shelter Survey

Introduction

The Treasury White Paper brought to the forefront the problems facing the tax system due to the growth of abusive tax shelters. The IRS recognized this problem and addressed it through strategic initiatives. The IRS's [Strategic Plan - Fiscal Years 2000-2005](#) states the following:

“Promoters of abusive tax shelters are using partnerships, trusts, and offshore entities in their tax schemes to unlawfully reduce or eliminate taxes. Many abusive schemes continue to thrive and new ones are being promoted regularly. Abusive corporate tax shelters are a major problem, not only because of the billions in tax dollars that are being lost but also because of the corrosive effect that is created if individual and small business taxpayers believe that large taxpayers are not paying what they owe. We have identified a proliferating range of schemes, which involve large amounts of money and many complex transactions, but which have no real business purpose other than reducing taxes.”

As part of its efforts to curb abusive tax shelters, the Service gathers data through surveys. According to the [Strategic Plan - Fiscal Years 2000-2005](#), the surveys are intended to, “... build strategic relationships with internal and external stakeholders and improve understanding of workload through continued analysis of nationwide field surveys. Field agents, Appeals, and Counsel will coordinate their efforts in this area. Working with Treasury, we will issue notices and guidance concerning abusive schemes as they are identified. We will leverage the information we receive to identify specific noncompliance, levels of noncompliance, and track trends.”

Surveys were conducted on LMSB cases in the CIC program in November 1999, October 2000, and November 2001. Additional surveys will be conducted as necessary.

Continued on next page

III.A.3. Tax Shelter Survey, Continued

OTSA Survey Agents should look for the abusive tax shelter characteristics noted below in all cases assigned to them. When at least four of these characteristics are present, the OTSA survey questionnaire should be completed. The characteristics to look for are:

- Lack of economic substance
 - Inconsistent financial accounting and tax treatment
 - Complexity
 - Unnecessary steps or novel investments
 - Confidentiality
 - Contingent or refundable fees and recession or insurance arrangements
 - High transaction costs
-

When to Complete and Where to Send The OTSA survey questionnaire should be completed as new shelters are identified, even if a questionnaire relating to another shelter has already been submitted on the same entity and year. Completed questionnaires should be encrypted and forwarded to OTSA through team managers and Territory Managers.

Continued on next page

III.A.3. Tax Shelter Survey, Continued

**How to
Download**

The Survey is on Access database and can be downloaded to your hard drive by **Right-Clicking** [OTSA Survey](#) and choosing “Save Target as”.

**Purpose, Use
and Results of
Information**

The information collected through surveys is used to identify the types of shelters that are prevalent in the business sector. Based on the types and numbers of shelters found, resources are allocated for maximum efficiency. Survey results obtained so far have been used to advantage in the following areas:

- 1) Funding for outside experts;
- 2) Allocation of resources;
- 3) Planning for training;
- 4) Identification of new shelter types;
- 5) Identification of agents experienced with certain shelter types;
- 6) Coordination of activity in working different types of shelters; and
- 7) Providing information to Technical Advisors to enhance coordination and assistance to agents.

Additionally, the survey information is used to make recommendations to Treasury and Congress.

III.A.4. Tax Shelter Hotline

Introduction Pursuant to its function as a clearinghouse for information that comes to the attention of the Service relating to potentially improper tax shelter activity by corporate and non-corporate taxpayers, OTSA maintains a Tax Shelter Hotline service. This Hotline provides a conduit to be used by persons wishing to submit information to OTSA relating to particular tax shelter transactions.

Purpose The Hotline was established in the year 2000 as a strategy to contend with noncompliance due to abusive corporate tax shelters. It was created as one of 10 major strategies to “Address Key Areas of Noncompliance.” See page 57 of the IRS Strategic Plan, which can be viewed at the website:

http://www.fin.irs.gov/osp1/html%20docs/SP_approved_final.doc

The following is an excerpt from “IRS Strategic Plan Fiscal Years 2000-2005.”

*“Corporate tax shelters – We will build strategic relationships with internal and external stakeholders and improve understanding of our workload through continued analysis of nationwide field surveys. Field agents, Appeals, and Counsel will coordinate their efforts in this area. Pre-Filing Guidance and Pre-Filing Agreements on Abusive Corporate Tax Shelter will be issued and, **“a Tax Shelter Hotline” will improve communications....** Agent training tailored to current abusive schemes and recent Treasury regulation changes will be a continuous on-line learning option. Working with Treasury, we will issue notices and guidance concerning abusive schemes as they are identified. We will leverage the information we receive to identify specific noncompliance, levels of noncompliance, and track trends.”*

Continued on next page

III.A.4. Tax Shelter Hotline, Continued

Hotline as a Tool

The Hotline also serves as a tool that allows the IRS to keep abreast of emerging issues and provide customer service to taxpayers that have concerns or questions about tax shelters. As information and inquiries are received through the Hotline, they are forwarded to Technical Advisors, Criminal Investigators, Treasury, Counsel, or Appeals, as appropriate. In instances where new types of shelters are uncovered, information is forwarded to the field and the public in the form of Memos, Notices, or new Regulations. When necessary, appropriate training is also offered to agents to detect and examine new shelters.

Form 211 Claim for Reward

The public can use the Hotline to anonymously report information on taxpayers engaged in abusive tax shelters. Informants may elect to receive a reward for information given, by completing Form 211. Rewards may be paid under 26 USC 6001, 6011, 6109, 7602, 7623, 7802, and 5 USC 301.

If OTSA generates a Form 211 from information it gets from the Hotline, it will send a copy of the Form 211 to the examining agent to be associated with the file. If you receive a Form 211 from OTSA, you should evaluate it using Form 11369, Confidential Evaluation Report on Claim for Reward. After sending the original of the 11369 Form to the proper Informants' Claims Examiner (as specified in the instructions to that Form), please send a copy to OTSA. For additional detail, see IRM 25.2.1-25.2.3.

**Contact
Information**

Submit information to the Office of Tax Shelter Analysis by mail, telephone, fax or email, as follows:

Mailing Address:
Internal Revenue Service
LM: PFTG
Office of Tax Shelter Analysis
1111 Constitution Avenue, NW
The Mint Building
Washington, DC 20224

Telephone number: (202) 283-8740

Toll Free Number: (866) 775-7474

Fax number: (202) 283-8354

E-mail address: irs.tax.shelter.hotline@irs.gov

III.A.5 Conclusion

Contact OTSA!!

OTSA can assist revenue agents by providing information on tax shelter transactions from its database on disclosures, registrations, surveys, and the Hotline.

Revenue Agents should contact OTSA, as well as their local Counsel and the appropriate Technical Advisor on all emerging, unlisted tax shelter transactions that they discover through audit.

These sources can provide valuable assistance in issue development.

Send Promotional Material to OTSA!!

All tax shelter promotional material or transaction material received through audit by a revenue agent should be sent to OTSA.

This allows the coordination of emerging issues by the IRS and the early notification of the public regarding abusive transactions.

Please click on the link below to see the phone numbers and mailing address of the employees in OTSA.

[Office of Tax Shelter Analysis Contact](#)

<http://lmsb.irs.gov/hq/pftg/otsa/contact.htm>
